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TREASURY FOR FTAT, OCC/SIEGEL, AND OASIA/ICB/MAIER
TREASURY PASS TO FEDERAL RESERVE AND SEC/E. JACOBS
PARIS FOR USOECD

E.O. 12958: N/A

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SUBJECT: Austrian Economy Looking Up; Long Haul Ahead

REF: (A) VIENNA 0856; (B) VIENNA 0615

11. SUMMARY: Austria's economy shrank 0.4% in Q2/2009 (versus the previous quarter), a sign of stabilization after the 2.7% first quarter contraction. Economists say the recession is coming to an end in Austria, but do not expect a swift upturn in the second half, and see further deterioration in the labor market. A coalition dispute over conditionality for GoA loan guarantees to industry could delay a key stimulus program. Recent data show few indications of a credit crunch in Austria and rates for commercial loans have in line with ECB monetary easing, but consumer spreads remain high, prompting a public outcry. END SUMMARY.

Current Snapshot

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12. According to interim report by the Institute for Economic Research (WIFO), Austria's GDP slide flattened in the second quarter. In Q2/2009, the economy contracted only 0.4% versus Q1/2009 (real terms, seasonally and working day adjusted), after a slump of 2.7% in Q1/2009. All demand aggregates were still negative in Q2/2009 (except private consumption, which continued to track upward) but the export decline was only 1% in Q2/2009 compared to minus 6-8% in the previous two quarters. Investments also showed a flattening downward trend, and as a result industrial production was down only 3% in Q2/2009 after a fall of almost 10% in Q1/2009.

Outlook: No Recession, but No Real Turnaround Either

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13. Economists in Austria expect further improvement in the third quarter based on polls, leading indicators, and stabilization in the world economy. WIFO economists express confidence in their June projection (ref A) that Austria's GDP will contract by 3.5% in 2009 -- i.e. the recession is basically over. Most economists say the better-than-expected second quarter results mark the beginning of the end of the recession -- but they do not expect a dynamic rebound in the late 2009 or in 2010.

Labor Market

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14. Austria's labor market situation continues to deteriorate (while still better than in much of the Eurozone). The unemployment rate has rise from an 3.8% in 2008 (annual average) to 4.4% in June 2009, with 230,000 unemployed -- up 33% from June 2008 and not including an additional 100,000 workers on subsidized furlough status and in training programs. Although the recession appears to be ending, the labor market will continue to worsen in 2010 -- with shrinking employment and rising unemployment.

Loan Guarantees for Industry

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15. The GoA has been quick to legislate economic stimulus but slow to

implement it (excepting income tax cuts, which were already on the agenda). In the latest example, loan guarantees to help industry (a EUR 10 billion program, carved out from the EUR 85 billion interbank bond guarantee package) have now run into a political roadblock.

¶6. BACKGROUND: The new loan guarantee program -- open to any domestic or foreign enterprise with a large jobs base in Austria -- offers market-based conditions and will still expose banks to some default risk. The maximum guarantee amount per loan is EUR 300 million and will cover 30-70% of the total loan amount, the maximum term is 5 years. A law creating the industrial loan guarantees was approved by Parliament in early July and went into effect August 19.

¶7. Implementation of the guarantee facility has stalled after a conflict between the governing parties over loan conditionality. The conservative OVP-led FinMin has the lead on drafting loan terms, but must obtain consent from the Chancellery (which is in social-democratic hands). After Parliament approved the law, Chancellor Werner Faymann and other Social Democrats proposed capping salary and bonus payments to managers of companies receiving GoA loan guarantees, a proposal rejected by conservative FinMin Josef Proell. At this dispute plays out, loans to over a hundred large industrial enterprises (who have applied for the guarantee) are on hold. Industry representatives warn that further delays may cause some companies to run into serious liquidity problems.

Credit Markets Easing, But Not for Consumers

¶8. Recent data show few indications of a credit crunch in Austria and the above mentioned GoA guarantee facility for industry loans

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should ease the situation further. Austrian National Bank data show a rise for both loans to industry and private households in June. Rates for bank loans to business and industry have fallen from 5.99% in October 2008 to 2.79% in June 2009 -- mirroring the 3.25% drop in the ECB'S leading interest rates. COMMENT: rates don't tell the whole story, since lending standards have risen, terms are shorter, and required collateral is much higher -- meaning that commercial credit is in fact considerably tighter.

¶9. In contrast, spreads between consumer deposit and credit rates are at very high levels. Loan rates for consumer credits have only eased from 7.18% to 4.95%, while deposit rates (one-year maturity) have cratered to 1.44% (from 4.77% before the crisis). Although Austrian consumer spending is not particularly credit-driven, perceived profiteering from the crisis has fueled negative press against the banking sector.

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